

This letter discusses whether sales of "Treatment Cards" and patent fees are subject to Illinois sales and use tax. See 35 ILCS 120/1. (This is a PLR.)

June 28, 2004

Dear Xxxxx:

This letter is in response to your letter dated November 18, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

We recently spoke to your associate, regarding the following ruling request, because we were unable to find authority on point. PERSON was kind enough to give us guidance on what issues we would need to address with respect to the two questions covered by this ruling request. References to this conversation will be incorporated in the appropriate sections of the ruling request.

On behalf of our client, COMPANY (or 'The Company'), we respectfully request that the Illinois Department of Revenue issue a private letter ruling pursuant to Ill. Admin. Code tit. 2, § 1200.110, stating that based on the facts set forth below, COMPANY's sales of the Treatment Cards are subject to sales and use tax and the patent fees are exempt from sales and use tax.

General Information

1. Enclosed please find an original Form IL-2848 Power of Attorney, authorizing FIRM to represent COMPANY before the Illinois Department of Revenue (the 'Department');
2. This Private Letter Ruling ('PLR') is not requested with regard to hypothetical or alternative proposed transactions. The PLR is requested to determine the Retailers' Occupation Tax ('ROT') consequences of the actual business practice of COMPANY;
3. This situation is not being examined as part of a Department audit of COMPANY, nor is COMPANY currently engaged in litigation with the Department with regard to this or any other tax matter;
4. The Department has not previously ruled regarding this matter for COMPANY. Neither COMPANY nor FRM has submitted the same or similar issue to the Department on behalf of COMPANY;
5. COMPANY requests that certain information be deleted from the PLR prior to dissemination to others. COMPANY requests that its name, address, the location of its facilities, description of products being sold, and the name of its representative be deleted; and
6. COMPANY knows of no authority contrary to the authorities referred to and cited below.

Facts:

The Company Overview

The Company develops patented surgical methods ('patented methods') to correct vision disorders.

While The Company engages in several business activities, for purposes of discussion, the business activities relevant to this private letter ruling request can be categorized into three specific transactions: (1) Sale, Lease or Rental of Laser Systems; (2) Sale of Treatment Cards; and (3) Charge for Patent Fees. The information provided below describes each of these business activities in extensive detail.

(1) Sale, Lease or Rental of Laser Systems

The Company designs and manufactures laser systems.

The Company requires purchasers and lessees of the Laser Systems to enter into a written agreement covering the sale, lease or rental of a Laser System ('SLR Agreement'). These SLR Agreements cover the terms and conditions of the sale, lease or rental of a Laser System and the purchase of Treatment Cards.

(2) Sale of Treatment Cards

The Company created a 'Treatment Card' to serve two important purposes: (1) to ensure compliance with requirements set by regulatory agencies and (2) to regulate the number of surgeries performed.

The Company sells Treatment Cards to licensed operators of Laser Systems. The Company charges a fixed price for Treatment Cards, regardless of the type of procedure to be performed.

(3) Charge for Patent Fees

The Company charges patent fees for the **right to perform** surgery procedure covered by The Company patents. The Company charges its customers different patent fees for different procedures, since unique patents apply to each type of procedure.

The Company requires all operators of the Laser Systems to enter into a patent license agreement ('License Agreement') in order to use the Laser System to perform any Licensed Procedure.

The Company Billing Practices

Although the purchaser of the intangible right to perform a Licensed Procedure may receive the information via the Treatment Card, The Company distinctly separates the two transactions by charging separate fees and including separate line items on billing invoices.

For illustrative purposes, a sample invoice for the purchase of Treatment Cards and the payment of patent fees is set forth below:

March 5, 2002

The Company
ADDRESS

Customer No. #####
ADDRESS

<u>Quantity</u>	<u>Product Item</u>	<u>Price/Item</u>	<u>Total Price</u>
50	Treatment Cards for **	\$ 10.00	\$ 500.00
150	Treatment Cards for **	\$ 10.00	\$ 1,500.00
50	Patent Fees - **	\$100.00	\$ 5,000.00
50	Patent Fees - **	\$165.00	\$ 8,250.00
50	Patent Fees - **	\$235.00	\$11,750.00
<i>Total Invoice</i>			<i>\$27,000.00</i>
<i>Taxable Amount</i>			<i>\$ 2,000.00</i>
<i>Sales Tax (6.25%)¹</i>			<i>\$ 125.00</i>
<i>Grand Total</i>			<i>\$ 29, 125.00</i>

The Company sells, leases or rents Laser Systems to both individual doctors and corporate centers or finance companies. In situations where an entity other than a doctor purchases a Laser System, the operator of the Laser System will necessarily be different than the purchaser.² As discussed in section (1) above, The Company requires the purchaser or lessee of the Laser System to enter into a SLR Agreement, which governs the terms and conditions of the sale, lease or rental of the Laser System. The Company requires all operators of the Laser System to enter into a License Agreement, governing the use of the Licensed Procedures. It therefore follows that in such situations, the signatories to the SLR Agreement will indeed be different than the signatories to the License Agreement.

The significance of the structure of the transaction described above is that The Company will bill the purchaser of the Laser System for the machine and it will bill the operator for the Treatment Cards and the patent fees, if applicable, for each Licensed Procedure performed. Thus, the owner and operator of the Laser System are often separate entities.

Usually, The Company issues separate invoices for the purchase of a Laser System and the purchase of Treatment Cards. The Company generally ships the Laser System and Treatment Cards separately as well. However, in certain situations, The Company may invoice and ship a few Treatment Cards along with the Laser System.

For customer convenience, The Company generally issues one combined invoice to a purchaser that includes charges for patent fees and Treatment Cards on a per procedure basis. Each charge appears as a separate line item on the invoice.

Ruling Requested:

The Company respectfully requests that the Department issue a binding private letter ruling confirming that:

1. The Treatment Cards are tangible personal property and thus subject to the Illinois sales and use tax, and
2. The patent fees for the intangible **right to perform** patented surgical procedures are not subject to the Illinois sales and use tax.

Legal Discussion:

Issue 1: Are the Treatment Cards tangible personal property and thus subject to the Illinois sales and use tax?

35 Ill. Comp. Stat Ann. 120/1 defines the term 'sale at retail,' for purposes of imposing the Illinois Retailers' Occupation Tax and provides, in relevant part:

'Sale at retail' means any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the

extent to which it is resold as an ingredient of an intentionally produced product or byproduct of manufacturing....Transactions whereby possession of the property is transferred but the seller retains the title as security for payment of the selling price shall be deemed to be sales.

The Company's business activities include selling Treatment Cards to doctors or others duly qualified to perform the Licensed Procedures. The Company sells some of these Treatment Cards within Illinois and thus, assuming such sales fall within the parameters of 35 Ill. Comp. Stat. Ann. 120/2, the sales may be subject to tax.

As set forth above, 35 Ill. Comp. Stat. Ann. 120/2 requires four elements to impose a sales tax: (1) a sale at retail; (2) of tangible personal property; (3) by a person engaged in the business of selling at retail; and (4) within Illinois.

The Company sells Treatment Cards for each of its patented procedures. As we discussed with the DOR representative, the Treatment Card functions as a sort of a single use key, which unlocks the machine using a digital access code and allows the user to perform a single patented procedure based on the type of Treatment Card.

While the Treatment Cards have no intrinsic value other than to allow the operator to unlock access to the Laser System, it is our understanding that since the Treatment Cards are in fact property that can be touched or perceived by the senses, the Treatment Cards should be classified as tangible personal property. In order to ensure proper collection and remittance of the applicable taxes, The Company requests that the Department confirm, based on the facts presented, that the Treatment Cards constitute tangible personal property subject to sales and use tax in Illinois.

Issue 2: Are the patent fees for the intangible right to perform patented surgical procedures subject to the Illinois sales and use tax?

The Company develops surgical methods to perform surgery to correct vision disorders. The Company patents such procedures as a means of protecting its intellectual property rights. The Company charges patent fees for the right to perform Licensed Procedures. The transfer of this right to perform a Licensed Procedure does not involve the transfer of tangible personal property, but rather involves solely the transfer of an intangible (right to perform patented surgical procedures).

Taxation under the Illinois Retailers' Occupational Tax Act ('ROTA') is specifically limited to transfers of tangible personal property. While tangible personal property is not specifically defined in the ROTA, the Department has previously taken the position³ that items such as patents constitute intangible personal property and are thus not subject to ROT.

The Retailers' Occupation Tax, Service Occupation Tax, Service Use Tax and Use Tax ('sales taxes') are incurred only when tangible personal property is transferred either at retail or incident to performance of a service. Consequently, these taxes do not apply to these categories: 'license (see however, 86 Ill. Adm. Code Section 130.1935(a)(1)(A-E), enclosed, which discusses licenses of software),' 'franchise,' **'patent,'** 'trademark,' and 'copyright' (emphasis added).

This classification of patents as 'intangibles' by the Illinois Department of Revenue supports the position that the patent fees charged for the right to perform a Licensed Procedure are payments to The Company for an intangible and thus, should not be subject to the Illinois sales and use tax.

The Department has also indicated informally that part of the taxability decision related to the patent fees would be whether the patent fees were calculated independently of the sales price of the Laser System. The rationale behind this request, as we understand it, is to demonstrate that the patent fees are not part of a deferred payment/conditional sale arrangement, but are a true charge for the right to perform a patented procedure.

1. Sales of Laser Systems Outside the United States. While The Company sells its Laser Systems both domestically and internationally, The Company does not charge patent fees abroad. The fact that the patent fees are independent from the selling price of the Laser Systems is evidenced by the similar selling prices of the Laser Systems in the domestic and international market. If the patent fees were part of the selling price of the Laser System, it would stand to reason that the price of the Laser System to non-U.S. customers would be higher to offset the fact that COMPANY does not charge patent fees abroad; however, that is not the case.
2. Sales of Treatment Cards and Patent Fees to users of non-Company manufactured equipment. Several other manufacturers produce vision correction systems that perform The Company's patented procedures. In such situations, The Company still receives a patent fee for each procedure performed even though the procedure was performed on a machine designed and manufactured by another company. If the charge for the patent fee was part of the sales price for the Laser System, it would stand to reason that The Company would not receive the patent fee for procedures performed on other manufacturers' laser systems.
3. Different Patent Fees for Different Types of Procedures. The Company charges different patent fees for different procedures. This pricing structure illustrates that it is the value of the intangible right to perform a specific type of procedure that determines the amount of the patent fee. Market demand for the unique features and capabilities of each type procedure dictate the value, and hence the patent fees, charged by The Company. The different patent fees for different procedures demonstrates that the patent fee is a separate fee for an intangible right and not related to the price of the Laser System.
4. Multiple Party Transactions. In multiple party transactions, The Company sells the Laser System to one entity (the purchaser), and sells the Treatment Cards and charges patent fees to perform a Licensed Procedure, to a separate person (the operator). Since the patent fee is for the right to perform a Licensed Procedure, The Company charges the performer (operator) of such procedure, rather than the purchaser of the Laser System, the patent fee. This billing distinction between purchaser and operator is significant in illustrating that patent fees are not connected to the sale or use of Laser Systems.

In summary, The Company sells Laser Systems and Treatment Cards, both tangible personal property, to customers in Illinois. Hence, the sales of the Laser Systems and Treatment Cards will be subject to Illinois sales and use tax. Furthermore, Illinois does not impose a sales and use tax on intangibles. The charges for patent fees for the right to perform a Licensed Procedure constitute a sale of an intangible and thus, such fees should not be subject to sales and use tax in Illinois. The Company separately invoices or itemizes Treatment Card sales and patent fees and even charges patent fees without corresponding Treatment Card sales in connection with cross-licensing and multiple party transactions. The Company does not charge patent fees abroad, yet the price of the Laser Systems is essentially the same as in the United States, illustrating that profits from the sale of Laser Systems are independent of the those profits realized in patent fee transactions. Lastly, The Company charges different patent fees for different types of Licensed Procedures, which illustrates that the patent fee is tied to the value of the intangible right to perform a certain procedure and not to the sale of the Laser System. The totality of these facts and circumstances indicate that patent fees do not represent a part of the purchase price of the Laser Systems and that the Illinois sales and use tax does not apply to the patent fees paid to The Company.

Conclusion

We respectfully request that the Illinois Department of Revenue confirm our conclusions as set forth above, regarding the application of the Illinois sales and use taxes to the sale of Treatment Cards and the charge for patent fees, so that we may advise our client accordingly.

If the Department cannot reach our conclusions as set forth above, I request that the Department contact me to determine what additional information is required or allow the taxpayer to rescind the ruling request.

Please feel free to contact me with any questions or to schedule a meeting to discuss any aspect of this ruling request. We appreciate your response on these issues.

In regard to the Treatment Cards, it is the Department's opinion that the Treatment Cards are tangible personal property and, as such, are subject to Illinois sales and use tax.

It is the Department's opinion that the patent fees are not tangible personal property and are not subject to Illinois sales and use tax. These fees represent charges for the intangible right to perform patented surgical procedures.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 217-782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk

¹ This sales tax rate is the Illinois state sales tax rate and thus, it does not include any applicable local taxes.

² The Company requires all operators of the Laser Systems to be fully licensed, legally qualified, and certified by The Company to perform the Licensed Procedures. A corporate laser vision center, due to its existence as an intangible legal entity, cannot fulfill these requirements. Based on current technology, only a human person can meet such requirements.

³ See Illinois Department of Revenue. Private Letter Ruling No. 94-0051 (Feb. 17, 1994). The taxpayer acknowledges that private letter rulings are only binding on the requesting taxpayer; however, PLRs are reflective of the Department's position on a particular issue.